No. 13225

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CROFTON DIESEL ENGINE COMPANY, INC., a corporation, and AL LARSON BOAT SHOP, a corporation,

Appellants,

vs.

PUGET SOUND NATIONAL BANK OF TACOMA, a corporation, and ETS-HOKIN & GALVAN,

Appellees.

REPLY BRIEF FOR APPELLANTS.

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REPLY BRIEF FOR APPELLANTS.

Introduction.

Appellants in their reply brief, propose merely to clarify some of the errors in Appellee's Brief. No effort will be made to restate or reargue Appellants' position.

I.
Question of Law or Fact.

Discussion of whether there is before the Appellate Court a question of law or fact seems easily resolved by the fact that this appeal is concerned with the narrow question: What is the legal effect of Appellee's documents which call themselves "Preferred" ship's mortgages? This is a question of law and has so been consistently held by this Court whenever interpretation of a writing is before the Court.

II.

Waiver by the Mortgage Terms.

A mortgagee can waive his right to a preferred mortgage lien at any time. (46 U. S. C. A. 974.)

If, for example, the mortgage had specifically stated that the mortgagor was authorized to incur maritime liens for "strictly current operations and repairs," there could be no argument but that a waiver had been made under the statute. If the wording of the exception to the clause prohibiting liens were similar to that in *The Henry W. Breger* (D. C. Md. 1927) (17 F. 2d 423, 432) (where the mortgagor was specifically prohibited from incurring any liens except for supplies) there would be a "tacit permission" for the imposition of a lien on the ship, and the preferred status of the mortgage would be waived *pro tanto.* The question here is whether Appellee, by choice of the mortgage form it used has waived its seniority to these maritime liens.

III.

How the Mortgages Waive Their "Preferred" Status.

The mortgagee in this case has waived its priority as to these lien holders:

(a) By use of a form designed for a situation in which it is assumed that the maritime liens for "strictly current operations and repairs" will be prior to the mortgage.

(b) Use of a form that, at least tacitly, authorizes the Vessel to be "run in debt," and the credit of the Vessel to be pledged for "strictly current operations and repairs."

(c) Use of a form that sets a ceiling on the time the liens can be outstanding (*i. e.,* they must be paid in 30 days).

(d) Failing to include the simple prohibition by the mortgagee of the mortgagor's authorization to give any paramount security on the ship, as was done in the *Morse Dry Dock & Repair Co. v. Northern Star* (1926, 271 U. S. 552, 46 S. Ct. 489, 70 L. Ed. 1082), and in *The Bergen* (C. C. A. 9th, 1933, 64 F. 2d 877) cases.

(e) Use of language (concerning running the Vessel in debt for a reasonable sum for strictly current operations and repairs to be kept currently paid within 30 days of date incurred) which is ambiguous, and should be construed most strongly against him who chooses it.

IV.

Status of Crofton's Mortgage as Security for Its Maritime Lien.

Crofton's note and mortgage was given as "evidence and security for goods, wares and services furnished the Vessel on order of the Respondents." (See Offer to Stipulate and Acceptance A. 67, 71.) Crofton, with knowledge, constructive or actual, of the presence of two documents calling themselves "Preferred" mortgages, is taken to have been aware of the existence of some rights or claimed rights arising out of Appellee's mortgages. What these rights were, he need not have decided. If they were only chattel mortgages when

they compete with maritime liens, his knowledge or belief is completely immaterial, when determining his rights. In charging him with being estopped to contest the validity of these mortgages, Appellee now seems to say that he should have resolved the ambiguous clauses concerning running the Vessel in debt (and of course charging the Vessel's credit for supplies and other reasonable expenses of operation) at his peril. This, the Supreme Court, in *The Stjerneborg* (1940, 310 U. S. 268, 60 S. Ct. 937, 84 L. Ed. 1197), was not a decision required of the supplier.

What if Appellee's mortgages had had the defect noted in the case of *Morse Dry Dock & Repair Co. v. Northern Star* (1926, 271 U. S. 552, 46 S. Ct. 489, 70 L. Ed. 1082)? Would then Crofton's designation of his preferred mortgage as "third" have precluded his security from being senior? Appellants here urge that the defect in Appellee's mortgages by reason of the *pro tanto* waiver of preferred status to maritime liens for "a reasonable sum for strictly current operations and repairs" is a much more serious defect.

Crofton, to bolster his maritime lien, sought the best security he could get and obtained a mortgage "third" in time of attaching. It is subsequent to Appellee's mortgages only if those mortgages are valid against his maritime lien. It is axiomatic that the Court, particularly the Admiralty Court, will regard the substance and not the form, and should, as Admiralty has done on many occasions, dispose of the entire problem. Ap-

pellee's statement that Crofton should have forclosed its maritime lien rather than to attack the security for the lien seems to be only an effort to disregard substance for form.

V.

Appellee's Cases Are Out of Point.

Appellants point out that in the case of the *Nan B* (D. C. Alaska 1948), 78 Fed. Supp. 748, relied upon heavily by Appellees, there was no question of waiver in the earlier mortgages. The subsequent mortgagee based his claim of priority on an alleged defect in the execution of the prior mortgage. We also doubt if the *Morse Dry Dock* case was brought to the Court's attention, because no mention is made of it. The District Court's reasoning seems at odds with that of the Supreme Court in the *Morse* case. The *Nanking* (D. C. Cal. 1923), 292 Fed. 642, upon which the *Nan B* is based, is, of course, overruled by the *Morse* case.

Appellants also rely upon the case of *Collier Advertising Service v. Hudson River Day Line* (S. D. N. Y. 1936), 14 Fed. Supp. 335 (aff'd C. C. A. 2d, 1937). 93 F. 2d 459). In this case, though there was a contest between maritime liens and a preferred mortgage, there was no question as to waiver of the status of the preferred mortgage due to ambiguity in the language or contents of the mortgage. The Circuit Court of Appeals, it may be noted, affirmed because the supplies were not delivered to the individual Vessels upon which the liens were claimed and therefore, no maritime liens ever arose.

VI.

The "Charter Party Rule" Applies to Preferred Mortgage Cases.

The reasoning of the Courts in Charter Party cases in similar situations in which the person in possession of a Vessel with apparent authority to pledge its credit is based upon sound principles of justice, precedent and the statutes, particularly Sections 971, 972 and 973 of 46 U. S. C. It is to be noted that the mortgagor in this case is a person authorized by Section 971 to create liens, and is a person to whom the management of the Vessel is entrusted (Sec. 972) if the Mortgagee is, in a sense, regarded as an "owner." The key in the Charter Party cases is Section 973, with reference to notice to the supplier. Can the supplier, Appellants in this case, be taken to have had knowledge, constructive or actual, that the mortgagor was "without authority to bind the Vessel therefor" (Sec. 973) when the document used for this "preferred" mortgage assumes that the Vessel will be run in debt, and its credit will be pledged "for strictly current operations and repairs" and all the mortgagee is retaining is the right to accelerate if these 30-day liens are not paid in the time specified? These same considerations have been presented to the Courts in the Charter Party cases, and in all other cases involving similar contests, including the few preferred mortgage cases we have located.

VII.

Discussion of the Bergen.

In this case (C. C. A. 9th, 1933, 64 F. 2d 877), relied upon by Appellee for the proposition that the preferred mortgage is senior to maritime liens, it is to be noted that there was an express prohibition of the power and authority of the mortgagor "to create, incur, or permit to be placed or imposed upon the property subject or to become subject to his mortgage, *any lien whatsoever.*" It should be noted that this Court discussed a subsequent ambiguity in the terms of the mortgage by which the mortgagor was obligated to pay off any liens in 15 days. But the case was placed squarely upon the grounds Appellants here assert—*seniority of the mortgage depends upon the express prohibition of the authority of the mortgagor to incur any liens!* In the *Bergen* case, there was such express prohibition and the maritime liens were postponed. In the case at bar there was no such prohibition, but there was a tacit permission, or an ambiguity or an assumption that there would be imposed for "strictly current operations and repairs."

VIII.

Conclusion.

Appellants therefore submit that the District Court's decree is erroneous and should be reversed.

Respectfully submitted,

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